Dollarama Inc.: Is it 1 of the Best Growth Stocks Around?

Description

The outlook for brick and mortar retailing has been pessimistic for some time. This can be attributed to the fundamental shift within the industry sparked by the internet and advent of e-commerce. While many traditional retailers have been struggling to maintain sales and grow margins**,** one brick and mortar retailer keeps bucking the trend.

That company is budget retailer **Dollarama Inc**. (TSX:DOL). Despite that the rapid growth of e-commerce is creating considerable headwinds for traditional retailers, Dollarama continues to innovate and grow.

Now what?

A crucial part of the company's future is its growth strategy focused on Latin America. Back in 2013, Dollarama struck a deal with Central American discount retail chain Dollar City to supply stock and business expertise. Because of that agreement, Dollar City has ratcheted up its presence in the region over the last four years to now have 77 stores in Guatemala and El Salvador and nine in Colombia.

The agreement gives Dollarama the option to purchase a majority stake in Dollar City in three years' time. Such a move would certainly bolster the company's franchise and give it exposure to what are increasingly important markets for retailers. It represents a significant growth opportunity for Dollarama because not only is Latin America developing at a rapid rate, but e-commerce has a very low penetration rate.

According to analysts' estimates, e-commerce sales only make up roughly 3% of all retail sales in the region compared to 10% globally and 6.5% for Canada. While there is considerable opportunity for e-commerce in Latin America, low penetration will continue for the foreseeable future because of a lack of internet access, infrastructure issues, and a traditional distrust of doing business online.

And with growing wealth, rapidly expanding populations, a rising middle class, and increasing political stability, there is considerable opportunity for a discount retailer like Dollarama. Consumers in the region are also more price sensitive than those in developed nations, making discount retailers that have a proven operational model more likely to grow than larger mainstream traditional brick and mortar retailers.

If Dollarama elects to exercise its right to take a majority stake in 2020, it will endow Dollarama with considerable long-term growth potential.

Regardless of the growing pressure from e-commerce, Dollarama is experiencing phenomenal growth.

For the first quarter 2017, year-over-year sales growth rose 10%, while EBITDA shot up by an impressive 16%, and Dollarama's operating margin grew by a full percentage point. The retailer is focused on expanding its footprint; it opened 13 new stores during the period compared to only eight a year earlier.

While Dollarama appears expensive, particularly with it trading at 29 times forecast earnings, there is good reason for this. The budget retailer expects to keep growing at a solid clip. For fiscal 2018, it plans to open 60-70 new stores, experience same-store sales growth of 4-5%, and grow its EBITDA margin by up to 1.4% year over year.

Further appreciation of Dollarama's stock will be supported by the company's recently announced share-buyback plan; it will buy up to almost 5.7 million shares over the next 12 months.

This benefits shareholders by reducing the number of shares available**,** subsequently boosting earnings per remaining share. It also highlights management's confidence in the business and their belief that the company is undervalued.

So what?

I am not a tremendous fan of brick and mortar retail stocks, but so far Dollarama has gotten the essentials right. It has identified and successfully targeted a high-sales volume niche market and established a robust low-cost operating model.

More importantly, management is focused on identifying new growth opportunities, and the deal with Dollar City, which could see Latin America become a key growth lever, is promising. For these reasons, even after its spectacular growth, there appears to be plenty of upside left for investors.

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